

DEPARTMENT OF STATE REVENUE

LETTER OF FINDINGS NUMBER: 01-0265
Adjusted Gross Income For Individuals
For Tax Years 1997 through 1999

NOTICE: Under IC 4-22-7-7, this document is required to be published in the Indiana Register and is effective on its date of publication. It shall remain in effect until the date it is superceded or deleted by the publication of a new document in the Indiana Register. The publication of this document will provide the general public with information about the Department's official position concerning a specific issue.

ISSUES

I. Adjusted Gross Income For Individuals—Unreported Income

Authority: IC 6-8.1-5-1(a); IC 6-8.1-5-4(a)

Taxpayer protests the Department's assessment of additional individual income tax liability.

II. Tax Administration—Abatement of Penalty

Authority: IC 6-8.1-10-2.1(d)
45 IAC 15-11-2

Taxpayer protests imposition of a ten percent (10%) negligence penalty.

STATEMENT OF FACTS

Taxpayer is the sole proprietor of a used vehicle business and a used vehicle dealer. Taxpayer acquires most of the vehicles that he sells from auto auctions in Indiana and Florida per customers' specifications. Taxpayer maintained no formal records of sales, cost of goods sold, or business expenses. Nevertheless, for the tax years in question, taxpayer reported his net profit from his business on *Schedule C-EZ of Form 1040 - Net Profit from Business* for federal income tax purposes. One of the requirements for filing a *Schedule C-EZ* form is business expenses must be \$2,500.00 or less.

Pursuant to an audit, taxpayer's *Schedule C-EZs* were examined for calendar years ending 1998 and 1999. Taxpayer was unable to provide his federal income tax return and other supporting tax documents for calendar year ending 1997. The audit revealed errors in

taxpayer's reported federal taxable income. For calendar years ending 1998 and 1999, taxpayer reported \$4,400.00 and \$4,300.00 respectively in gross receipts. From the documents available, it was determined that taxpayer underestimated his adjusted gross income by at least twenty-five percent (25%), in that taxpayer's cost of goods sold was determined to be \$141,865.00 for calendar year ending 1998, and \$183,045.00 for calendar year ending 1999. For calendar year ending 1997, adjustments were made using the best information available. Due to the errors, the Department assessed additional individual income tax liability against taxpayer, and concluded that taxpayer should have filed a *Schedule C* (Form 1040) tax return.

I. Adjusted Gross Income For Individuals—Unreported Income

DISCUSSION

Taxpayer protests the method used by the Department to determine taxpayer's true business income for tax years 1997, 1998 and 1999. Taxpayer failed to maintain complete records as required by IC 6-8.1-5-4(a), which states: "Every person subject to a listed tax must keep books and records so that the department can determine the amount, if any, of the person's liability for that tax by reviewing those books and records."

Due to the lack of complete records, the auditor had to estimate the assessment by reconstructing taxpayer's vehicle sales, cost of goods sold, and business expenses. The Department made the proposed assessment pursuant to IC 6-8.1-5-1(a), which states in part: "If the department believes that a person has not reported the proper amount of tax due, the department shall make a proposed assessment of the unpaid tax on the basis of the best information available to the department." IC 6-8.1-5-1(a) also states: "The notice of proposed assessment is prima facie evidence that the department's claim for the unpaid tax is valid, and the burden of proving that the proposed assessment is wrong rests with the person against whom the proposed assessment is made."

The Department determined that taxpayer arbitrarily selected a total expense amount that was less than \$2,500.00 and filed the *Schedule C-EZ* (Form 1040). From the documentation provided, the Department determined that taxpayer's cost of goods sold was well over \$100,000.00 for each of the tax years in question. Taxpayer has protested the results of the audit, but has provided no evidence to support that protest. As such, the Department did not err in assessing taxpayer additional individual income tax liability on the underreported amounts, and determining that taxpayer should have filed a federal *Schedule C* (Form 1040).

FINDING

Taxpayer's protest is denied.

II. Tax Administration— Abatement of Penalty

DISCUSSION

Taxpayer protests the imposition of a ten percent (10%) negligence penalty. IC 6-8.1-10-2.1(d) states that if a person subject to the negligence penalty imposed under said section can show that the failure to file a return, pay the full amount of tax shown on the person's return, timely remit tax held in trust, or pay the deficiency determined by the department was due to reasonable cause and not due to willful neglect, the Department shall waive the penalty. 45 IAC 15-11-2 defines negligence as the failure to use reasonable care, caution or diligence as would be expected of an ordinary reasonable taxpayer. Negligence results from a taxpayer's carelessness, thoughtlessness, disregard or inattention to duties placed upon the taxpayer by the Indiana Code or Department regulations.

In order to waive the negligence penalty, taxpayer must prove that its failure to pay the full amount of tax due was due to reasonable cause. 45 IAC 15-11-2. Taxpayer may establish reasonable cause by "demonstrat[ing] that it exercised ordinary business care and prudence in carrying out or failing to carry out a duty giving rise to the penalty imposed" 45 IAC 15-11-2(c). In determining whether reasonable cause existed, the Department may consider the nature of the tax involved, previous judicial precedents, previous department instructions, and previous audits. *Id.*

Taxpayer has failed to set forth a basis for establishing that he exercised the degree of care statutorily imposed upon an ordinarily reasonable taxpayer. Given the totality of the circumstances, waiver of the penalty is inappropriate in this instance.

FINDING

Taxpayer's protest is denied.